

2012

# SPRING NEWS



## Smith-Milne & Co Limited

Park Farm House  
Ducks Hill Road  
Northwood  
Middlesex  
HA6 2NP

t: 01923 83 23 03

f: 01923 83 23 06

e: [office@smithmilne.co.uk](mailto:office@smithmilne.co.uk)

w: [www.smithmilne.co.uk](http://www.smithmilne.co.uk)

ACCA

### Director

Justin Smith-Milne FCCA

Registered to carry on Audit Work and regulated for a range of investment business activities by the Association of Chartered Certified Accountants



## Every silver lining has a cloud

Good news: HM Revenue & Customs decided to extend the deadline for filing tax returns because some of its call-centre staff were on strike. As people wouldn't be able to get answers to last-minute queries, they decided it wouldn't be fair to charge penalties for two days. Computers don't go on strike – one of the reasons managers like them – so taxpayers could still file online; but HMRC confirmed that they would treat all returns received up to midnight on 2 February as on time, even if the taxpayer wasn't affected by the strike.

The last possible moment is not the best time to do anything, of course – things go wrong and there is no margin for error. It's better to have the information in good time and have a chance to check it. So in an ideal world, tax staff going on strike on 31 January would have no impact. Still, last year more than half a million people filed their returns on the last available day, so the extension is important to a lot of taxpayers.

The underlying bad news is a dispute between HMRC staff and their employer. It may seem like a good thing if it helps us avoid penalties, but if it means post piles up unanswered, the phone rings off the hook and no-one tries very hard to be helpful, that makes dealing with tax much more taxing. This strike is about what the unions suspect is creeping privatisation – bringing in private-sector firms to try to reduce waiting times for telephone enquiries – but there are wider problems with HMRC morale. The department recently published a staff survey which disclosed that only 18% feel that HMRC is managed well, and only 17% have confidence in the decisions made by HMRC's senior managers. There are some other very blunt and honest statistics in the report.

This newsletter highlights some of the good and bad news on tax from recent months. Whether HMRC's call centres are at work or not, we'll be happy to help you deal with the taxman. •

## The good seed

Mr Osborne has announced a new tax relief from 6 April 2012 that seems almost too good to be true. We are familiar with the Enterprise Investment Scheme – subscribers for shares in small unquoted trading companies can enjoy a 30% income tax rebate on the amount invested. Under the Seed Enterprise Investment Scheme, this goes up to 50% – and capital gains realised in 2012/13 will be exempt if they are reinvested in a SEIS company. That can save another 28%, so £100,000 invested (the maximum) could only cost £22,000 after tax relief.

There are restrictions, of course. The company is supposed to be small (gross assets less than £200,000) and new (less

than 2 years old, undertaking or planning to undertake a new trade). The investor can't own more than 30% of the company, as with EIS. The company has to use the money in the business within 3 years of the share issue, or the relief is lost.

This is such an attractive incentive that keen investors are likely to outnumber good investments. Some previous schemes of this type have led people to throw their money at anything that appeared to qualify, sadly ending up with a tax-efficient loss. It's definitely worth keeping an eye open, though, for anything that might succeed – even if the company lost half the £100,000, the investor would still make a good return! •



---

## Pension limits

There's one thing that's certain with pensions: by the time you come to draw yours, the rules will have changed several times. In the 2011/12 tax year, the maximum tax-allowable contribution to pension schemes has been cut to £50,000, with some complicated rules about using the limit of the previous three years if you didn't pay £50,000 in each of them (even though the maximum was different under the previous rules).

If you retire with a pension pot bigger than your 'lifetime allowance', there's a tax charge. In 2011/12, the limit is £1.8m. On 6 April 2012 it falls to £1.5m – still a lot of money, but the charge will be significant for someone who has a pot larger than that. You can apply for 'fixed protection' which avoids the charge on up to £1.8m, but restricts the amount you can contribute to a pension fund afterwards.

If you want some help understanding what you can put into pension funds, or whether your pension fund might trigger the lifetime allowance charge, we can help. ●

---

## Know your supplier

'Know your customer' is a good maxim for doing business. The VATman has issued a warning to businesses who use temp or agency staff – know your supplier.

A few years ago, the big VAT fraud involved selling mobile phones or computer chips to someone, charging them VAT (which they would reclaim) and disappearing before HMRC could collect the money – a 'missing trader fraud'. These days, people are more wary of these areas of business, and HMRC reckon that there is a risk in the sub-contract labour business – supply of staff is a standard rated VATable supply, so businesses may pay VAT to agencies and expect to be able to claim it back as input tax. If the agency has disappeared without paying HMRC, HMRC may not be happy to hand the input tax over.

They suggest a long list of sensible commercial checks to carry out, similar to the advice they give to anyone dealing in mobile phones – don't take the supplier at face value, but make sure they are genuine. HMRC think there's a particular risk this year with the London Olympics likely to drive up demand for temporary staff – if you want to discuss how to protect yourself, we can advise you. ●

---

## Late later latest

There's been a lot of publicity about the new penalties for late submission of income tax returns, but the PAYE penalties were put up last year and plenty of people have fallen foul of them. Fortunately the Tax Tribunal has come to the rescue of several employers who were facing substantial fines for failing to file the P35 annual summary or monthly Construction Industry Scheme returns.

One judge quashed a penalty because he ruled that it was up to HMRC to prove that the taxpayer was in default – the opposite of the normal rule for tax liabilities in general – and they didn't have enough evidence. He cancelled another because he accepted that the bookkeeper genuinely believed that the return had been filed, even though it had gone astray. He cut another penalty from £500 to £100 because HMRC had taken a long time

to issue a penalty notice – if they had done it quicker, the employer would have been able to put the situation right and wouldn't have racked up the bigger fine.

The same judge also criticised HMRC's interpretation of a 'reasonable excuse' which can cancel a penalty – they think it has to involve an 'exceptional circumstance'. He didn't think that was what the law said. The words had to carry their ordinary English meaning, which would be likely to involve a much lower threshold.

Ideally, you don't have to argue about excuses because you comply with all your many tax responsibilities on time. If you want help understanding what they all are, we can explain – and if something goes wrong, we can advise you on whether to argue the point with the taxman. ●

---

## Know your limitations

One of the quirks of VAT law is that you only get four years to claim back overpaid VAT from HMRC – but a customer can demand an overcharge back from a supplier for six years. So if you charged someone 'plus VAT' five years ago, and they now discover that the supply was exempt, you could be stuck – they can claim the money from you but you can't get it back from HMRC. This is clearly unfair, but fortunately it doesn't happen too often.

Now the European Court of Justice has given a ruling that suggests it's not just

unfair – it's against EU law. They say that someone with a right – such as a right to get back some VAT they shouldn't have paid – can't be deprived of that right by this sort of discrepancy in a member state's laws. It's not clear exactly what the court thinks ought to happen – whether the customer gets the money directly from HMRC, or HMRC would have to give it to the supplier in order to refund the customer – but it seems that HMRC can't rely on an unfair law. ●

---

## Home thoughts from abroad

A British man who made his home in the Seychelles and carefully restricted the number of days he spent in the UK each year to 90 was surprised to find that HMRC still considered him taxable here. He believed that HMRC's custom and practice, if not the law itself, was to treat people like him as non-resident for tax purposes. When the appeal commissioners agreed with the taxman, he took his case all the way to the Supreme Court to argue that HMRC were being unreasonable in not applying the practice published in their booklet IR20.

The judges decided (by 4-1) that he did not have a case. IR20 was poorly written, but people had read too much into it if they thought it was a promise of non-resident treatment in this man's circumstances. It was necessary to have made a distinct break with the previous way of life as a UK resident. A property kept in the UK had to be 'for use' but not 'a home'. The 90-day count referred to 'visits', which suggested something more irregular that would be done from a base that had shifted fundamentally to the foreign location.

Anyone who wants to become a tax exile has to take this new interpretation into account. HMRC have proposed a new statutory test of residence, but they've now decided to put that back to 2013. If you want to discuss your residence status in the meantime, we'll be happy to help. ●



---

## Digging up the dirt

HMRC are usually allowed to ask you questions about your tax return for 12 months after you've filed it. However, if they discover something wrong with it – whether or not by asking you a question – they may be able to ask for more tax for a longer period than that. There are rules to protect the taxpayer: you are safe from a discovery assessment if HMRC should be aware of all the circumstances from the information that you have provided and they have taken no action within the enquiry window.

It can be difficult to show that you have given them enough to satisfy this test, but some taxpayers have recently won appeals based only on this point – they had paid too little tax, but HMRC had missed the opportunity to collect it. One involved a supplier of medical locums who had no income for 10 years but still claimed loss relief for the expenses of trying to restore his registration with the General Medical Council. When HMRC finally realised that he wasn't really trading they tried to take back some of the loss relief they had given



him in previous years, but the Tribunal held that they had been given all the information and had done nothing about it at the time.

If HMRC start looking at past years, they may be able to collect more tax but you may be protected. We can advise you. ●

---

## Food and drink

The Tax Tribunal has been dealing with important issues again – to go with 'Jaffa Cakes are cakes, not biscuits' and 'Pringles are like crisps', we now have 'Lucozade Sport is a beverage, not a food'; concentrated iced tea is tea; and United Biscuits' 'Frisps' are not like crisps because there's more wheat flour in them than potato.

The UK's rules on VAT and food famously don't make sense. If you make or sell food, it's important to be confident that HMRC won't ask for VAT that you haven't collected because you thought the product was zero-rated. If in doubt, ask for a ruling – get the VATman round for a cup of tea and a biscuit. Or maybe a cake. ●

---

## The artful lodger

Rent-a-room relief has been around for years – if you receive rent of up to £4,250 a year for letting a room in your only or main residence, you don't have to pay tax on it. Whether this increases the availability of accommodation is open to debate – probably the best result is that it allows what many people did anyway (taking money from a lodger without declaring it).

There are limits, though. It is supposed to be a room in the house you live in – you can't extend it to a buy-to-let investment

property. In a recent case, a woman who owned four properties omitted the rent from one of them from her tax returns. The Tribunal agreed with the taxman that she probably didn't live there – after all, her husband and two children lived in one of her other addresses, and this was a small terraced house with a tenant. She had to pay the tax and a penalty.

If you aren't sure what income is taxable and what you can leave out, we can advise you. ●

---

## Going quietly...

How many pages of tax law are filled with ministers' brilliant ideas that turn out to be a waste of ink? If you have overpaid your tax, submitting your return entitles you to a refund; a few years ago, we were given the option of donating some or all of that to charity. This mixed two things that didn't really go together, and it seems that not many

people used it. The facility is being withdrawn from 6 April 2012, which will shorten by one question the business of filling in a tax return.

You can, of course, still donate money, shares or land to charity and enjoy tax reliefs. If you are feeling charitable, we can explain the ways in which you can give and save. ●

---

## Not so interesting

If you get a repayment of income tax or corporation tax, it generally comes with interest. Not much, but some, and it's automatic. If you get some VAT back, you have to claim interest, and they'll only pay it if you can show that the overpayment was their fault rather than yours. If you claim some input tax late because you forgot, they will have had the money in the meantime but they won't owe you any interest.

Even if you are entitled to interest – remember, that's because HMRC were wrong to collect the tax from you – they pay a low rate set by law and they calculate it on a simple basis, not compound. Over a few years, that makes a huge difference. So some taxpayers who have won the right to repayments of VAT going back to 1973 have argued that they ought to be paid something more realistic – a bank would compound interest and charge a higher rate, and the business may have had to borrow from a bank for 30 years because HMRC have had the money, so surely compensation should come with compound interest.

Some very large claims have been made, but the Advocate-General of the European Court has given an opinion that favours HMRC. It isn't certain yet, but she suggests that this is the sort of thing that EU member states should be allowed to determine for themselves – if there was no interest at all the ECJ would step in, but as there is some, that's all right.

If you have had a VAT repayment in recent years, you will want to watch out for the final outcome. The court usually agrees with its Advocates-General, but occasionally goes the other way. HMRC will be hoping this one follows the normal course. ●

---

## Capital falling

Remember that the Annual Investment Allowance for plant and machinery falls from £100,000 to £25,000 on 1 April for companies and 6 April for income tax traders, and there are peculiar rules if your accounting period straddles that date. Writing down allowances will fall at the same time from 20% to 18% on the general pool and from 10% to 8% on the special rate pool.

If you want to review your capital expenditure plans to maximise your tax relief, we can work out the numbers for you. ●



---

## Company exits

If a company is liquidated, all the money distributed to shareholders is liable to CGT – at 10% (if Entrepreneurs' Relief is available), 18% or 28%. If the company pays a dividend before being liquidated, that's chargeable to income tax – taking the 10% tax credit into account, there's nothing more to pay for a basic rate taxpayer, 25% of the net amount for a 40% payer and 36.1% of the net amount for a 50% taxpayer.

For many years, HMRC have allowed the CGT treatment where a company is informally dissolved rather than liquidated. From 1 March 2012, they are going to restrict this to distributions which don't exceed £25,000. If the amount is more, it will all be charged to income tax – although you could pay a dividend first to leave exactly £25,000 on dissolution.

If you have a company with substantial accumulated reserves, and you are thinking about how to get the money out in the most tax-efficient way, we can advise you. ●

---

## Business or personal?

You can only claim expenses against your profits for tax if they are 'wholly and exclusively for the trade'. If something has a private motive, it isn't allowable at all – unless the private is completely incidental to the business. Two recent appeals on legal expenses show how fine the line can be.

One appellant ran a transport company. One of his drivers caused the death of a pedestrian, and he was prosecuted for gross negligence manslaughter and for conspiracy to pervert the course of justice. He was found not guilty on the first but convicted of the second. He claimed £270,000 in defence costs against his business profits over 3 years. HMRC ruled – and the Tribunal agreed – that keeping himself out of jail had to be at least a significant part of his motive for spending the money. It wasn't only about retaining his operator's licence so the business could continue – none of it was allowable.

The other appellant ran a business advising high net worth individuals on investment opportunities. When the CEO of a company wrote to shareholders claiming that he had lied in e-mails, he and his company sued for defamation, and claimed legal costs of £459,000 incurred in bringing the action. Here, the Tribunal accepted that preserving the business was the sole reason for the expense, and any personal benefit to the individual's reputation was a by-product.

If you are not sure what is an allowable expense, we can help. ●

---

## Sacked or not sacked?

An employee and her employers discussed the possibility of her moving onto a self-employed basis. They left it as something to be considered further. Then she received a letter stating that her employment would be terminated 9 days later, with immediate re-engagement on a self-employed basis. She claimed unfair dismissal.

The company tried to take back the notice. The directors claimed that they had believed the employee had agreed to this – that this was what she wanted. If she didn't,

no problem – just tear up the letter and carry on as before.

For whatever reason, she did not accept this. Now that she had received the letter, she would rather take the money – compensation for what was clearly an unfair dismissal under the law – and run. The Court of Appeal agreed that this was her right. The letter was an unequivocal notice of termination, and the misunderstanding was not enough to amount to a special circumstance that would invalidate it. ●

---

## Jackpot pays out?



For the past six years, HMRC have been resisting claims that there was a problem with the UK's laws that charged VAT on some gaming machines but exempted others. If the machines were so similar that the punter

wouldn't be able to tell the difference, the argument went, then they should all be treated the same. Owners and operators of machines put in huge claims for repayment of VAT they had accounted for in the past.

Now the European Court of Justice has confirmed that the taxpayers have won, in principle. Rank, who took the leading case, have secured a big windfall. HMRC are still clutching at some of the straws in the ECJ judgment, and may not pay out all the claims they have – they may ask for more details of the machines to find out which exempt ones they are supposed to be identical to. So the claimants who jumped on Rank's bandwagon may have to wait a little longer.

There's probably a bookie offering odds on the taxpayers winning, though... ●

---

## Slicing and dicing

If you have an investment bond, you are generally allowed to draw out 5% of the original capital each year without triggering a tax charge. If you draw more, it's taxable – and if you cash the whole bond in, you'll pay tax on a gain over the amount invested. If it's a UK bond, 20% tax will be treated as paid already, and you'll only be liable to higher rates.

A recent case highlighted a pitfall. It's common for these bonds to be sold as a series – 20 'segments' of £10,000 rather than one lot of £200,000. So if you take out £40,000, is that 20% of each of the bonds

– with a tax charge on the excess over 5%, £30,000 – or is it perhaps the whole of some of them, in which case you work out whether you've actually made a gain or not?

The taxpayer said he'd cashed in some segments completely, but the paperwork didn't bear it out. The judge said it was ridiculous that there was significant tax to pay when the investments hadn't gone up in value, but that was the law.

If you have investment bonds and you're thinking of cashing them in, we can advise you on how much tax you will pay – and how you can minimise that. ●

---

## Unrelieved interest

If you run a business and borrow money by loan or overdraft to finance it, you can generally set the interest you pay against the profit you make. If you own a trading company and take a bank loan to invest in it, you can claim tax relief for the interest on that, making the loan cheaper – it costs you 80% or 60% or 50% of the interest rate, depending on your marginal rate of tax.

Some taxpayers recently found to their cost that you can't claim relief for interest on a personal overdraft which finances

a company – it's got to be a fixed loan. Overdraft rates are usually higher than loan rates anyway, but the tax rules make them even worse – even though the overdraft interest would be allowable if the business was run as a sole trade, or if the company itself had the overdraft, the way these traders had set up their finances meant there was no relief at all.

If you want to know the tax implications of any borrowings you have or are thinking about, we can advise you. ●